Internal Revenue Service

memorandum

CC:TL
Br4:HGSalamy/JRDomike

date: OCT 02 1987

to: Regional Counsel, [redacted]
Attn: Deputy Regional Counsel (General Litigation) CC: [redacted]

from: Director, Tax Litigation Division CC:TL

subject: [redacted]
(aka [redacted])

This is in response to your request for technical advice on the taxability of contributions issue in the above-entitled case.

ISSUE

The issue presented is whether contributions to an organization are includable in gross income in the years received when the organization held a favorable determination that it was a tax-exempt public charity under I.R.C. §§ 501(c)(3)/170(b)(1)(A)(vi) during the years of receipt but which determination was subsequently revoked retroactively. We note that while [redacted] has not yet been actually revoked by the Service, the issue is raised because of the Service's need to file a proof of claim in the bankruptcy court on the primary or alternate basis of non-exemption. The issue is raised in connection with [redacted]'s [redacted], [redacted] and [redacted] years.

CONCLUSION

As discussed more fully below, we do not believe that the Government should take the position that the contributions are taxable in this bankruptcy litigation. We will provide you with a detailed discussion of the taxability issue at a later date.

08349

DISCUSSION

Facts

The facts as set out in your memorandum are as follows. [redacted] was recognized by the Service as exempt under I.R.C. § 501(c)(3) on May 17, 1973. It is also classified as a publicly supported foundation under I.R.C. §§ 509(a)(1)/170(b)(1)(A)(vi) although [redacted] maintains that it is also a church under I.R.C. § 170(b)(1)(A)(i). 1/ [redacted] is under examination by the Service; it is proposed that the exemption be revoked on the basis of inurement, retroactively from [redacted]. 2/

The examination by the Service disclosed that [redacted]'s primary activity is its religious [redacted] operation, called the [redacted]. [redacted] supporting the [redacted] program during the years in issue (called "partners" though we ascribe no particular meaning to that word for purposes of this response) were the major support of funding. 3/ Requests for funds were made during the [redacted] and in separate mailings; the solicitations were aimed at keeping the [redacted]. It is not clear that all contributions received by [redacted] were used for the religious [redacted]. Some funds were earmarked on an intermittent basis in a specific account while others were recorded in the general contribution account. The major portion of [redacted]'s expenses was incurred for the religious [redacted].

1/ On the church issue, see Foundation of Human Understanding v. Commissioner, 88 T.C. No. 75 (May 19, 1987) (radio broadcast religious organization may be a church).

2/ See our September 21, 1987 memorandum to you regarding the need to actually revoke [redacted]'s exemption in order to sustain a proof of claim in bankruptcy court based on non-exemption. Also, other guidance regarding the ongoing examination was given to you in the General Litigation Division's memorandum of September 4, 1987.

3/ While all contributors may have been referred to as "partners", if in fact a contributor or partner received a substantial quid pro quo in return for the contribution, no deductible gift was made. Furthermore, as you are aware, [redacted]'s other activities, including dealings with partners, may give rise to unrelated business income.

During the first three years of the period under examination, [redacted]'s revenues were as follows:

Source/Classification	Year Ended [redacted]	[redacted]	[redacted]
Contributions:			
[redacted] & Mail Solicitations			
General	$ [redacted]	$ [redacted]	$ [redacted]
Designated (missions, etc.)	[redacted]	[redacted]	[redacted]
Bequest & Donated Prop.			
Church Offerings			
TOTAL CONTRIBUTIONS RECEIVED:	$ [redacted]	$ [redacted]	$ [redacted]
Church Bookstore Income-Net	[redacted]	[redacted]	[redacted]
Interest Income			
Gains from Sale of Assets			
Other	$ [redacted]	$ [redacted]	$ [redacted]

We have no information regarding expenses, although it is believed that when reasonable expenses are allowed, there may be little (if any) tax liability from treating the contributions as gross income under I.R.C. § 61.

Your proposed position

You conclude that in view of the significant amounts involved, the Service's interests are best protected by taking the position in the bankruptcy litigation that the contributions are includable in [redacted]'s income under section 61 and not excludable as gifts under section 102. You recognize that the issue is one of first impression with no direct case law precedent. The Chief Counsel's Office has never formally

considered the issue. In the Government's favor here is the fact that the contributions by the [redacted] were made within the context of [redacted] activities. You discuss the Supreme Court's Duberstein 4/ standard in connection with two cases which, while dealing with business-type entities, are relevant to the I.R.C. §§ 61/102 issue. Webber v. Commissioner, 279 F.2d 834 (10th Cir. 1955) ([redacted] activities); Publishers New Press, Inc. v. Commissioner, 42 T.C. 396 (1969) (publishing activities). Both Webber and Publishers New Press found that amounts contributed so that taxpayers could continue their activities are includable in gross income. Reaching an opposite conclusion is Bail Fund of the Civil Rights Congress of N.Y. v. Commissioner, 26 T.C. 482 (1956), acq. 1969-2 C.B. xxiii (amounts contributed to a taxable, non-profit trust for use as bail for persons held in state custody are gifts). Bail Fund contains no supporting rationale; you posit that Bail Fund may be distinguished on the basis that the contributors received no direct benefits. Like the contributors in Webber and Publishers New Press, you believe it could be argued that [redacted] contributors did not act with detached and disinterested generosity in responding to appeals to keep the [redacted].

Law

The starting point of our consideration must be Duberstein. 5/ In Duberstein, the Supreme Court stated that a voluntary transfer without consideration is not necessarily an excludable gift within the meaning of I.R.C. § 102. A gift in the statutory sense, the Supreme Court noted, "proceeds from a 'detached and disinterested generosity.'" 363 U.S. at 285. What controls is the intention with which the payment is made; whether the transfer amounts to an excludable gift must be determined on the basis of all the facts and circumstances surrounding the transfer. Applying a Duberstein test in Webber (while that case was decided prior to Duberstein, it is consistent therewith) and in Publishers New Press, those courts concluded that no excludable I.R.C. § 102 gifts had been made.

4/ Commissioner v. Duberstein, 363 U.S. 278 (1960).

5/ I.R.C. § 118 dealing with contributions to the capital of a corporation may provide another basis upon which to exclude the contributions from gross income. We have not considered the matter further in light of our recommendation herein.

As you recognize, the difficulty in applying the Duberstein standard here is the fact that [redacted] was exempt at the time the contributions were made. The Service has taken the position that the Duberstein "detached and disinterested" generosity test, in its strictest sense, does not apply to determining whether or not an I.R.C. § 170 deductible contribution was made by a donor. GCM 34863, I-4119 (April 21, 1972), position affirmed on reconsideration, GCM 36713 (April 20, 1976); Rev. Rul. 78-232, 1978-1 C.B. 69 (quid pro quo test). 6/ Therefore, even though the contributions here also met the I.R.C. § 170 standard for deductibility, they are not per se I.R.C. § 102 gifts because of the different standards involved.

If the Service is to argue that the contributions are not excludable from [redacted]'s gross income under the Duberstein test, it must do so in the context of the [redacted], drawing on analogy to Webber and Publisher New Press. The argument would be that the contributors, in responding to the solicitation, gave the money to keep the [redacted] because they enjoyed the [redacted]. Our difficulty with that position is that, at the time the gifts were made, [redacted] received the funds to carry out its charitable and other exempt activities. The performance of exempt activities is not, in our view, an individual service to the donor. Furthermore, although the continuation of the [redacted] may have provided a non-economic benefit to [redacted], that same benefit was available to viewers who did not contribute to [redacted]. Thus, we believe it might be difficult to persuade the bankruptcy court that donors were not motivated by charitable gift impulses, within the Duberstein definition.

6/ The courts have continued to struggle over the question of whether I.R.C. §170 requires "an investigation into the subjective intent or motive of the transfer." See the discussion in Miller v. Commissioner, 4th Cir. No. 86-20290 (September 17, 1987). There is no question, however, that the sine qua non of a charitable contribution is a transfer of money or property without adequate consideration. United States v. American Bar Endowment, 477 U.S.____, 106 S.Ct. 2426 (1986).

Even if the evidence shows that the contributions were intended by the donors as gifts, 7/ we are not overlooking that inurement has occurred. Clearly, the inured funds constitute gross income to the individuals involved. Taxation in that manner may be sufficient. Depending on the facts and circumstances and what the Government may be able to show took place, however, we are not ruling out an argument based on fraud, deceit or conspiracy in the overall fund raising. In light of such showing that the funds were not solicited for charitable purposes, we believe there would be little question from a Service perspective as to taxability. Similarly, if [redacted] is revoked because it is engaged in a substantial non-exempt commercial enterprise, a firmer basis for taxability would exist.

The issue that you pose also raises a larger question regarding the Service's role in the revocation process, and its obligation to protect the integrity of the income tax when an organization is revoked. The public perception has to be that the Service is carrying out its responsibilities properly. It is clear that innocent donors can retain their I.R.C. § 170 deductions, even if an organization is revoked retroactively. We discussed this aspect of the revocation process in our September 21, 1987, memorandum to you. It may be argued that protection of the I.R.C. § 170 deduction requires that, upon revocation, the organization treat the moneys raised as I.R.C. § 61 income without more. 8/ The Chief Counsel's Office needs time to study the issue in more detail.

7/ We agree with you that the burden of proof would be on [redacted] to prove that the contributions are excludable under I.R.C § 102.

8/ We note that charitable assets are required to be permanently dedicated to charity. Here, it appears that remaining assets of [redacted] will wind up in a new post-bankruptcy exempt organization. Any amounts paid to the Government as income tax on contributions would, of course, reduce the assets in the new charitable organization.

Our advice to you at this time and on the facts as presented, is not to include contributions in [redacted]'s gross income. The bankrupcy court would not, in our view, be the preferred forum in which to decide this important question of first impression.

The issue of the taxability of contributions is under consideration in the Interpretative Division for an OM. We will send you a copy of the OM once it is complete.

ROBERT P.RUWE
Director

By: _____
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